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Gates Industrial Corp. Plc (GTES)

Evercore ISI Industrial Conference

CORPORATE PARTICIPANTS

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

OTHER PARTICIPANTS

David Raso
Analyst, Evercore ISI

MANAGEMENT DISCUSSION SECTION

David Raso
Analyst, Evercore ISI

Hi, thank you, everybody, for joining us again. As our day continues, really excited to have Gates Industrial joining us and who better than their CEO, Ivo Jurek. He's been with the company now through the journey, coming out as a separate company, a lot of heavy lifting. And then, of course, the setback around the pandemic was obviously unforeseen. But kind of coming out of that and hopefully, the COVID issue is mostly behind us, let's hope. But other issues are afoot when it comes to Fed, to geopolitical. So a lot we can talk about. But Ivo, first is, obviously, thank you for taking the time.

I'll turn it to you if you have any kind of opening remarks, things that you want to make sure investors hear about Gates, some key initiatives that you're thinking about, and I'll be happy to take it from there with questions.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

Terrific. Thanks. Thanks for inviting me and always a pleasure to participate at your conference, David. And look, Gates has had a – an interesting journey since the IPO. We have, for a good measure, gone through what I think somebody termed as a Trump – President Trump China recession. Once the recession started coming, breaking through, we go straight into a global pandemic and then we'd be operating over the last couple of years in a very, very interesting operating environment. But when I take a look, in particular over the last couple of years, so the – maybe the last two years of the pandemic, Gates has performed very, very well throughout 2020 to 2022.

And we like to compare ourselves to a premium industrial peer group, some of the much higher multiple industrial – multinational industrial companies. And when I take a look at 2019 and – sorry, when I take a look at 2020 and 2021, Gates kind of performed very much in line with the premium industrial peer group in 2020, so the peer group was down 8% to 9%, core Gates was down about 8.6% on core, so a right smack in the middle. And when you take a look at 2021, we have delivered despite all the difficult impediments that everybody had to deal with, we have delivered a 21% core growth in 2021, so nothing to be ashamed of while that same industrial peer group of premium peers have delivered about a 13% core growth.

So, we feel good about how we have positioned the company. We have delivered terrific results. We have delivered record revenues for the company in its history in 2021 and nearly record level of profitability. So the company is in very good shape. Over the last three years or so, we have positioned the company to take advantage of a number of secular growth trends that we believe will be with us for a very long time. I've spoken a lot about chain-to-belt opportunity for the company. Meanwhile, we have kind of [ph] segmented that (03:08) opportunity into personal mobility or micromobility-based chain-to-belt that has continued to deliver terrific, terrific results just over the last four years, basically coming from about $20 million of revenue in 2018 timeframe to nearly 4% of the total company revenue. So, do the math, about $140 million of terrific amount of growth over that period of time and continued to accelerate. And the industrial – diversified industrial opportunities with displacing the industrial chain by Gates highly precision engineered, carbon reinforced belting that offers tremendous amount of not only ESG benefits, but operating benefits for the companies that adopt our solutions. So we're very optimistic about those secular type opportunities and frankly exiting 2021, we've exited with markets the end markets that we participate in a very good shape. Perhaps all markets with the exception of our participation in automotive OEM markets are in expansionary period of time and so we are very well positioned to take opportunity on those growth trajectories as soon as we start seeing much greater breakout of the impediments that everybody is facing vis-a-vis raw material, COVID and logistics and distribution.

So in a nutshell, we feel good about where we sit. I think we have great set of opportunities out there over the mid-term and we're really excited about being able to share those with our investors and the analyst community in greater detail next Tuesday in New York in the Grand Hyatt, the Park Hyatt during our Investor Day.

QUESTION AND ANSWER SECTION

David Raso
Analyst, Evercore ISI

Q

Yeah. That'd be great, I will definitely be in attendance. Regarding Russia, Ukraine, just to level set everybody, can you give us a sense of direct exposure? Are you voluntarily shutting down sales in those parts of the world? How does it also maybe filter through your supply chain? Maybe it's a Tier 2, Tier 3, Tier 4 that's having greater challenges to get nickel or whatever the raw material might be. Just curious how you're sitting down with your operating folks and getting that feedback and maybe some tactics that you're taking?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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Yeah. I think it's a great question. First of all, I would remiss if I didn't share the horror under which we watched the atrocities that are unwinding in Ukraine. [indiscernible] (05:52) uncalled for and it is a terrible situation. That being said, we have very de minimis amount of revenue that we generate in the region, very low single digit – low single-digit amount of revenue that we generate out of Russia and Ukraine. And we have been very proactively looking at, frankly, getting ourselves to a position where we are no longer supplying anything in advance of the sanctions to that region. We don't believe that the amount of revenue we generate is material and we do not rely on any raw material supply out of Russia for the products that we manufacture. So, our exposure is reasonably limited. Again, very low single digits in terms of revenue exposure and no material dependency on raw material supply out of Russia.

David Raso
Analyst, Evercore ISI

Q



Okay. And given, though, that situation, unfortunately, is also causing a little, let's say, sustainability to some of the inflation that might have been more than transitory already, but this obviously gives it maybe even a little more fuel to that fire. How does that make you think about when you can get price-cost back to being margin neutral, not just price-cost neutral, but margin neutral? If you can take us through the timing on that and maybe some of the recent events, how that impacts the calculus?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. So, David, we have been, I think, pretty realistic about what we believe we will see with inflation in 2022. Honestly, we have seen that inflation ramp up quite significantly in – at the second half of 2021. And we did manage to be price material, economics neutral so not margin neutral but certainly price material, economics neutral. We've had a little bigger gap in Q4 that certainly impacted our operating margins in Q4 and we've anticipated and we've guided for a compression of margins through Q1 as well. But we believe that Q4 and Q1 – certainly Q1 of 2022, will be kind of the peak of the impact that we will see on our margin vis-à-vis inflation.

We've anticipated that we will continue to see energy spikes. We certainly are going to be very proactive to manage any further increases in energy cost globally that we may see as a result of this invasion, unlawful invasion into Ukraine. And should we start seeing a dramatic acceleration beyond what we've planned on, we will continue to roll-up more pricing.

Absent that, we anticipate that our pricing in certainly in the second half of 2022 and as we exit 2022, should be adequate for us to be margin neutral vis-à-vis inflation that we have seen and we are seeing at this point in time.

So we have enough price that we have rolled in. Pricing has been rolling in from the beginning of Q1, so from beginning of January. It will take few more months before it ramp up through all the channels, all the customers globally, and again we believe that Q1 of this year is going to be the most impacted quarter of the year. And as we exit Q1 into Q2, we will start getting more positive on pricing, material economics as well as margin economics.

David Raso
Analyst, Evercore ISI

Q

And that said, while 2Q is better than margins in aggregate, EBITDA margin still down year over year in 2Q. But you're still comfortable given the comp, I think people would hope so, right? Third quarter your margin should back – back to being up year over year. Is that a fair?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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That's how we – that's how we envisage, David, that it will – it will develop. Now, obviously, again, back to your point should inflation ramp up further, we will continue to take prices and we'll continue to adjust for inflation as we see fit.

David Raso
Analyst, Evercore ISI

Q

And when it comes to your product being so replacement channel-centric, it's easy for me to sit here and say, hey that – I mean, somebody's belt breaks on a car. I mean, you can charge what you want. I mean, you obviously have, if not number one, clearly one of the very top brands of the industry by far. You just would think it'd be fairly easy market and I appreciate at yearend there were some timing issues and trying to work with customers on

don't try to get a, you know, October 15 or November 1 increase if you're going to have one in January. But the reaction that you can have if inflation works against you, the mechanism now that we're not around a year end issue. If I told you your costs were going to surprise you by 50 bps, come 2Q or 3Q, how quickly can you get that in? And again, being a replacement channel it's easier for me to say than you'd execute, but I would think it wouldn't be that challenging to get a price increase through?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Look, it isn't really how challenging is the price to get through the channel. I think that the channel understands and is more than receptive in being able to take whatever inflation is running through the manufacturer's database. The complexity gets in when you start talking about repricing the entire price book. We supply tens of thousands of SKUs to these replacement channel customers. And it's about the mechanics of being able to get all the right pricing so that they can take the price to shelf on their end.

And so, we still believe that 90 days is the right timing for us to be able to get this pricing into the shelf at our customers. But look, if there is a situation where we believe we need to do much more dramatic set of steps, we can certainly do that much faster. Look, we ultimately price on shipment. So as you know, as we get pricing rectified, all the shipments that goes post price increases get invoiced at the new pricing. So we have levers that we can pull in any emergency and should we see more significant disruption in 2022 than what we have seen in 2021, we would do that.

But we also believe that our relationships are important. They are relationships that have been built over 100 years of history as Gates Corporation. We value those and we want to be – we want to be effective and efficient in rolling pricing into the end market. And you know, that's how we have – that's the decision we have taken in Q4 and we believe it was the right decision. And we will certainly reasonably quickly catch up to the inflation that we have seen over the last 90 or 180 days.

David Raso
Analyst, Evercore ISI



While I haven't gotten the impression supply chains are improving, would you say they're at least going according to your plan this year and thus, again, outside of any geopolitical shock on cost, the availability of your components so far that you need the raw materials, would you say is no better, but you just give me the playbook, I know my pricing will kick in, and that's sort of the situation, or have you seen some pockets maybe it's improved or it's gotten worse?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. Look, David, we actually are in a little bit maybe a unique situation because we use highly engineered compounds. Many of these compounds, a number of these compounds actually have been impacted in 2021 by the Korean War Act that was enacted in combat of the COVID-19 pandemic. And so we had more constraints that we have had to live with in 2021 from a number of very critical raw materials that we utilized in building our products. I'd say that the Korean War Act has expired at the end of December. And so on my call in Q4 – on my Q4 earnings call, I stated that we are actually seeing some green shoots in raw material supply. And so we are starting to get somewhat cautiously optimistic that as we exit Q1, we will be in much better situation than we have been in 2021. When I say green shoots, I didn't say we are off to the races. We've got to get that material into our factories and we've got to position it in the factories of point of use.

So things are improving, but they are not great yet. There are still raw material shortages. But they are – I would say they are not as broad based as what we have seen in 2021. And so we are more cautiously optimistic and we believe that as we enter Q2 and we work through Q2, we should be in much better situation than frankly what we have – what we have seen in the second half of 2021 in particular.

David Raso
Analyst, Evercore ISI

Q

When I think about that, I think about your individual business segments, is there one of the two segments that should benefit most from those highly engineered compounds being more available? Is it the belts, I mean, the PT power transmission business or is it the FP or really no distinguishing feature between the two that would benefit?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

David there's no real distinguishing feature. I mean, I think that, on one side, you could say that we have more benefits on the Power Transmission side. Unfortunately, some of the other constraints that we are still living with are also impacting the Power Transmission business. And so I would say net-net, it is hitting or it is improving across the portfolio in a measured, meaningful way for both of our product segments.

But we will still be dealing with some degree of material constraints, I think well into 2022. But again, we've managed through significant constraints in 2021. We will certainly be managing through some of those that will remain in place and some things will get easier and there are things that are getting easier. And we are, again, cautiously optimistic that things will be better for us as we enter Q2 of 2022.

David Raso
Analyst, Evercore ISI



And if I have my numbers right, it seems like you're implying EBITDA margins flat for the year, right, down year over year in the first half. Growing in the second half, we come back to basically flattish margins year over year, EBITDA margins. Is there something distinguishing between PT and FP on there year over year? Like Fluid may be in a position of – to be up a little bit, and PT is down. Is there – can you give me a little color on how to think about the margins by segment?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah, look, David, we don't necessarily guide by the segment, as you know. But both of these segments behave reasonably well in harmony with each other. And as long as we can secure raw material, as long as we secure labor to be able to convert the raw material into finished goods, both of these segments will benefit. Again, both segments are getting a good level of pricing on the products that we merchandise to our customers, so we'll be expecting that maybe the growth is going to be a little better in Fluid Power in 2022. But, look, we still believe that if you eliminated the comps, and the comps in the first half are also very difficult because we have two of the best quarters in the company's 110 year history in Q1 and Q2 of 2021. So comp is an issue. You really didn't have lots of inflation in first half of last year, and that inflation crept in, in second half of the year. And as I indicated, we still believe that we're going to be challenged in first half of the year with [ph] price mature (19:11) economics to a degree until we start getting the right side up in second half of the year. So the comp as well is an issue that comes to play in the first half. But I would say that I would look at both of these segments kind of more in harmony and both will benefit.

David Raso
Analyst, Evercore ISI

Q

Can you give us a little insight into China? I mean, I think if I have it right, maybe it's 11%, 12% of your revenues, not huge, but clearly not immaterial. Can you give us a sense – you have a little more, I think, auto OE exposure there than maybe the average geography as you're still kind of building out that auto business into more of a replacement focused business. But any insight you can give us on maybe how the government is signaling to your folks on the ground about kind of post-Olympics, post Chinese New Year, what is generally for a lot of people have been a down market. I know China for you last year was up, I think 19%, but I think it was down in the fourth quarter. Can you give us a little color on what you're seeing on the ground?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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Sure. Maybe from a strategic perspective we have spent, I would say, considerable effort to continue to build our industrial business and frankly, our broader presence in the replacement channel. [ph] Listen (20:30), I spent quite a bit of time in the last few years to talk about and highlight that and felt pretty bullish about what it is that we were doing.

Our business in China in Q4 has been primarily impacted by a decline in automotive OEM and the construction equipment demand. So again, in the first fit channel. So, the other OEM in the construction channel in Q4 were reasonably weak. Our growth initiatives are targeting diversified industrial and personal mobility end markets, very much similar to what we have talked about more broadly from a company perspective. And we have shown very good progress in China with those initiatives as well, and we see plenty of good opportunity there for those initiatives to ramp up.

So, if I take it – kind of look at the puts and takes, why we have a good level of confidence presently with China is that we can once again deliver a core growth kind of in that mid-single digit level as we work through some of the impediments in the automotive business. In the first half, I think that the situation is getting a little bit better, maybe is a good way to characterize on the auto OEM side, as we get past the Olympics and some of the restrictions that were layered in China in Q1 post-Chinese New Year. We believe that the industrial activity is going to pick up in the second quarter and that bodes well for our business and gives us even greater confidence that we will again deliver another year of positive core growth in China.

And China has been a very good business for us. It is a large economy. It's an economy. It's probably third largest industrial economy and again, I underline the word industrial. And so, I believe that we have plenty of runway to continue to deliver growth and continue to scale up our business there. We don't really import anything out of China, anywhere to any country outside of China. So everything that we [ph] have China (22:53) is for China and we believe that those opportunities to continue to capitalize on the growth of China are still very robust and remain intact.

David Raso
Analyst, Evercore ISI

Q

Given the leverage you came out on the IPO over five years ago, right, I think it was 5, 6 times levered something like that. Now you're a lot more, I'd say, in a healthy position at 2.5, 2.6 times net debt to EBITDA. How should I think about your comfort with now really leaning forward with the balance sheet or just given, I mean from the Feds, the geopolitical, whatever it may be right, COVID recedes and we have other things to worry about. Where are you in your appetite to really use the balance sheet in 2022 or it's a little more of a wait and see kind of block

and tackle more on the price cost and the margin? And then it's more of a 2023 story on maybe leaning forward with the balance sheet, another year of deleveraging, let's say.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah, look, I mean, as you said it very eloquently, we have not really had the balance sheet to put to work in a meaningful way over the last few years. And so I'm really delighted that we got ahead of our timeframe on delevering the company. And that really speaks volumes about our ability to deliver cash flow, continue to grow the business, and continue to grow earnings. So all of these three attributes helped us to delever the business faster than what we've anticipated.

That being said, we're now in a position to put the balance sheet to work. There are tremendous amount of opportunities in terms of M&A. Look, yes, maybe people are starting to ask themselves, hey, should I be doing M&A during an environment that may be somewhat problematic. But we believe that if the opportunities to add a good company to our portfolio are there, we will lean forward to do something.

We also believe that our stock is undervalued. As you know, we have gotten an authorization to buy back over $200 million of shares from – of the outstanding shares in the marketplace. And we'll certainly continue to ensure that we do that. And that being said, we continue to invest in our business in terms of organic growth. Again, I spoke little bit about some of our situation vis-à-vis the growth opportunities that are out there. Generally speaking, the investment into organic growth initiatives is the one that's got the highest IRR. And so we will continue to prioritize that. But I think that there's room for us to do all three and we will not wait until 2023 to do a combination of them. We'll continue to ensure that we do the right thing and we return capital to shareholders, as well as we invest in opportunities that will generate the highest return for our shareholders.

David Raso
Analyst, Evercore ISI


Q

Is it fair to say from that answer that share repo is at least as high on the priority near-term as M&A?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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Absolutely. It absolutely is. Look, David, we are caring way too much cash on our balance sheet and we don't need as much cash. So we got plenty of opportunity to do a share repurchase as well as do M&A.

David Raso
Analyst, Evercore ISI

Q

And when it comes to M&A, when I think of your bigger initiatives, they feel more PT-centric. But when it comes to M&A, is that an oversimplification of also where you want to invest? Or do you feel your core strength maybe is more differentiation, more core PT than Fluid Power, where [ph] I suppose (26:56) you're just not quite as dominant as you are in PT in that Fluid Power space?

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

Yeah. Look, I would say that maybe it feels that way because we have spoken about FP maybe from 2018 through 2019 and we've made a major investment to scale up that business. And frankly, it's delivered very strong returns for us. I mean, our FP business last year grew 24%. I'll put that number out there against anybody. And I'll also remind you that we're a top three market shareholder in Fluid Power globally. So we're actually one of the

biggest market participants globally in FP and we believe that we've kind of spoke our piece. We are well positioned, we revitalized the portfolio and we execute on that strategy kind of as a run rate strategy. So we are in a very good shape in FP.

We haven't really done all of the same amount of work in PT. And maybe that's why it feels like we talk more about PT. We are revitalizing our portfolio, which we started a little bit later than we started on Fluid Power. And we believe that that secular opportunity in chain to belt is so large that we've got to be laser focused on execution. And frankly, we've got to make sure that we don't run out of capacity to be able to support the continued growth of a pipeline of opportunities, and new business that we have – that we have won and have allocated to Gates over the next 18 months, which is quite substantial. And so our focus on PT is do just that, stay focused and continue to execute and revitalize the portfolio. On FP, we are in a very good shape.

David Raso
Analyst, Evercore ISI

Q

And the factories that you built that now finally have some tailwind to really fill them up. Have they given you most of that benefit so far, in a sense, so you mean, obviously 2020 was unfortunate to have the factories ready to turn on, provide better margin, then the volume didn't show up. But with the volume in 2021 and now the start of 2022, from here is it more traditional operating leverage or is there still a lot to go with those factories versus the legacy footprint...

[indiscernible] (29:17)

David Raso
Analyst, Evercore ISI

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...factories that much more profitable and still had room to grow...

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

A

No, absolutely. I think that the new factories gave us everything that we've anticipated, it gave us the position and proximity to these markets. Look, we have grown really very nicely in Fluid Power in Europe in particular where that factory that we've built in Poland has been the first – the first factory that we had in the European community producing Fluid Power and that's delivering terrific results. Our factory in Mexico that we have doubled in size in 2018 has been delivering terrific results for us. So we feel that those factories are doing exactly everything that we've anticipated. Again, remember, we have stated that we wanted to build those factories to scale up Fluid Power and give ourselves an opportunity to reposition our manufacturing footprint to locations where it is easier to find people and to globalize our business.

And so we have done just that and we are very pleased with what happened and we believe that as price material economics are going to start leveling off at some point in time in the near-term future. We will see a very nice expansion of operating margins as well.

David Raso
Analyst, Evercore ISI

Q

I'll leave it with this. Is it fair to say you seem fairly comfortable with the numbers out there for the year and kind of how you're seeing it play out on be it margin or revenue, however you get there. You seem pretty comfortable with and where the Street is and how we're thinking about the numbers for 2022.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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Today, I absolutely am. What I have learned over the last two years is that there's always going to be the next challenge.

David Raso
Analyst, Evercore ISI

Q

Sure.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

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And we've got to be ready for it. And I think that this organization, this company and the management team is ready to deal with the next challenge, although we would all like to see a degree of stability in the economics out there. But we are very realistic about what is potentially going to occur in the near-term future and we'll manage through it and we believe that we have a great business, highly engineered precision components that are critical in application that they are used that need replacement. That's a really wonderful position to be in and we are very optimistic about 2022 and beyond what we can deliver in terms of servicing our customers, facilitating and transition to more efficient manufacturing footprint for our customers, easier use of our products, and ultimately generating greater returns for our shareholders.

David Raso
Analyst, Evercore ISI

That's great. Well, we really appreciate you taking the time. Hopefully, have some other good meetings the rest of today and we'll be watching. So really appreciate it and we'll see you in-person next Tuesday. So that's great.

Ivo Jurek
Chief Executive Officer & Director, Gates Industrial Corp. Plc

Thank you.

David Raso
Analyst, Evercore ISI

Thank you. Really appreciate it, Ivo. Have a great day. And thank you everybody for listening in.